

USE OF THE FEDERAL TAXING POWER FOR OTHER
THAN REVENUE PURPOSES

BY

JULIAN DONALD MORGAN

A.B., University of Illinois, 1934

M.A., University of Illinois, 1935

AN ABSTRACT OF A THESIS

SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE
DEGREE OF DOCTOR OF PHILOSOPHY IN ECONOMICS IN THE
GRADUATE SCHOOL OF THE UNIVERSITY
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TO
H. K. A. and M. H. H.
whose valuable advice made
this study possible

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As generally understood, the taxing power is that authority of a government to secure from its members through assessment, according to general rule, without a *quid pro quo* relationship, the economic goods and services essential to its existence. While this concept of the taxing power emphasizes only the function of revenue acquisition, it does not follow that other functions are non-existent or without importance. Although historically overshadowed by revenue acquisition, "other than revenue" functions of the taxing power have long served to restrain or to stimulate trade. In practice the taxing power has been and must have been used for "other than revenue" purposes, for the very act of exercising this power has imposed a necessity of considering the problem of who is to be taxed and what altered economic relationship would be least undesirable. Moreover, in practice the Federal Government has gone beyond the minimum and has used the taxing power to effect changes which have had no essential relationship to the acquisition of revenue (state governments have also used the taxing power for non-revenue purposes).

It is the purpose of this study to show the extent to which the Federal Government has used the taxing power to achieve "other than revenue" objectives, or to show the extent to which the expected effects of a tax have been the motivating factors behind the enactment of the levy, and, furthermore, to show the trend of this movement. One should appreciate that a study of this nature cannot reflect scientific accuracy owing to the character of the source materials; however, notwithstanding this weakness, it is believed that the motivating factors behind particular taxes can be approximately ascertained through a careful examination of committee hearings and reports and the debates of Congress. Expressions of Congressmen recorded in these sources generally seem to have been frank and honest and at any given time to have been consistent.

On the basis of the objectives sought, the material has been divided into two parts. Part I embraces "other than revenue"

uses of the taxing power which are primarily of a political or legal nature and which alter or modify, directly or indirectly, the distribution of powers of our governmental organization. In this part will be included those taxes which have been levied substantially for the purpose of making it possible for the Federal Government, in effect, to circumvent the Supreme Court's interpretation of the Constitution by legal methods or to make more effective its delegated powers. Inasmuch as these appropriated powers do not result *per se* in an extension of governmental powers as a whole, but rather in a redistribution of existing functions, the problem presented bears essentially on political organization alone. Part II will include those "other than revenue" uses of the taxing power which are fundamentally of economic significance, though not without political importance, such, for example, as taxes to control or alter business practices. The taxes taken up in this part present a problem of somewhat different nature in that they involve a matter of a substantial change in government activities as a whole—an altered relationship between public and private economy. This development bears closely on that problem of political philosophy, so vital today, which concerns the relationship of public and private economic activity. The tariff has not been considered, owing to the fact that William Hill and E. E. Schattsneider have satisfactorily shown the extent of non-revenue objectives in the levying of customs duties.

The multiplicity of purposes and objectives behind a number of taxes makes it necessary to treat them from more than one point of view. For example, the oleomargarine tax was designed to aid the dairy industry as well as to prevent deception in the sale of oleomargarine, and the tax on white phosphorous matches was incidentally to exercise a function within the scope of the state police power as well as to control labor.

Three rather distinct, unorthodox uses of the Federal taxing power which are largely political or legal in nature, are those uses by which the Government in practice has assumed functions belonging, legally, to the state governments, those uses through which it has encouraged or aided the states in the performance

of the states' own functions, and those uses by means of which existing Federal powers have been made more effective.

Through a number of taxes the Federal Government has, in effect, extended its authority to fields generally believed to lie within the domain of the state police power. One of the first taxes designed, among other reasons, to protect the people from fraud—generally recognized as a function of the state governments—was the tax of two cents per pound on oleomargarine enacted in 1886 at the request of the strong dairy interests. During consideration of the bill, proponents constantly reiterated the argument that the tax was the only effective means to protect the people from the dishonest sale of oleomargarine—revenue was not considered. The tax was to raise the price of oleomargarine and thus curb its sale, and in addition, the tax regulations were to identify the product. In 1902 when the tax on uncolored oleomargarine was lowered while at the same time the tax on colored oleomargarine was raised to an almost prohibitive level, the same argument was expressed by the same groups. Doubtless there was a measure of truth in this view even though it was apparently utilized by the dairy interests simply as an opportune weapon for enhancing their competitive position. By no means did the proponents of the measure as a whole take an altruistic interest in the welfare of the consumer. This was clearly demonstrated time and again. Before the turn of the century taxes of a similar nature were levied on filled cheese and mixed flour. The purpose of these taxes, as well as of the oleomargarine taxes, was to eliminate fraud in the sale of goods as well as to help particular economic interests.

That this policy of exercising powers believed to belong to the states was no temporary innovation was indicated by the adoption in 1914 and 1934 of taxes designed not to return revenue but to restrict the sale of narcotics and firearms. No pretense was made by any Congressman that either levy was other than a regulatory measure enacted through a tax levy. Many members of Congress did, however, object to what they called an abuse of the taxing power.

Another "other than revenue" use of the taxing power of a political nature has been the use of taxes to aid in the exercise

of other Federal powers. One of the most widely known taxes in this category was the ten per cent tax on state bank notes levied in 1865 for the purpose of driving state bank notes out of existence. According to the Supreme Court, Congress, through its control over the currency, might well have eliminated these notes through their outright prohibition. Some time later Congress in exercising its power over commerce levied a small tax on immigrants, and still later in the Bituminous Coal Conservation Acts of 1935 and 1937 it levied taxes to effectuate a policy constitutionally dependent on the commerce power. Relatively minor taxes have been used to secure information and to make other tax laws more effective. Had Congress no power over interstate commerce, it is highly probable that the taxing power would not have been construed so as to sustain most of these levies.

Owing to the inability of the various states to cooperate with each other as Congress believed they should, tax offsets have been used to secure uniformity of legislation among the different states. The offset used has consisted of credits on Federal tax assessments for payments made under certain state tax laws which have met definite Federal standards. Although the use of the offset method to achieve uniformity had been suggested some time before, it was not until 1924 that Congress utilized this scheme through the adoption of a twenty-five per cent credit on the Federal estate tax. Later, under the Social Security Act, the Federal Government made use of a ninety per cent offset in order to induce the states to adopt uniform unemployment compensation laws. Both offsets were highly successful in coercing the several states into adopting the desired laws, for within a short time more uniform estate and unemployment laws were enacted. Many Congressmen fully appreciated the significance and objectives of these offsets, which offered a workable means for overcoming one of the objections to our political system, that is, the problem arising from a lack of uniformity among state laws where uniformity is desirable.

On a number of occasions the Federal Government has used the taxing power for "other than revenue" purposes which are

primarily economic in character. Several times taxes have been used to extend Federal authority over labor in order to establish certain standards heretofore generally considered to be within the scope of private employer-employee relations. A problem lying within the realm of state police power was settled when the Congress in 1913 enacted a prohibitive tax on the manufacture of white phosphorus matches. With scarcely a question both Houses accepted a tax designed not to raise revenue but to eliminate white phosphorus matches, the manufacture of which caused the dreaded disease, popularly known as "phossy jaw." A few years later, after resort to the interstate commerce power had prove unsuccessful, Congress sought to eliminate child labor through a high tax on concerns knowingly employing children below a specified age. With the advent of the Roosevelt Administration an effective demand for old age insurance for various workers was crystallized. Since it would have been difficult to force private business to adopt old age insurance plans, and since private plans do not possess a stability believed to be essential, Congress, through tax levies on wages, sought to establish what was in effect a publicly controlled private old age insurance scheme. Although some attempt was made by leaders of the proponents to cloak the true purpose of the levies, the attempt was generally unsuccessful, for as usual Congressmen, particularly opposition Congressmen, were very frank in expressing their views. Unlike the child labor tax, this levy was sustained by the Supreme Court.

Following the business depression of 1929, the agricultural interests, faced with even lower prices than those of the Twenties, sought with renewed vigor to enlist Federal support for some means which would restrict production and thereby augment agricultural prices. Within three months after President Roosevelt was inaugurated, Congress enacted the Agricultural Adjustment Act, which utilized processing taxes on wheat, pork, cotton, and other products to raise revenue, the spending of which was to curtail production through subsidies contingent on crop restrictions. To supplement this production control program, taxes designed to restrict production were levied on the ginning of cotton and the sale of tobacco and potatoes. In spite

of the temporary character of these levies, their effectiveness in restricting production was demonstrated beyond a doubt. It is, therefore, not improbable that similar levies may again be used in the future when a more liberal Court is in existence. Another tax levied primarily for production control purposes was the small tax on petroleum production which was to provide information essential to the successful operation of the Federal "hot oil" law as well as to raise revenue sufficient to enforce the act.

Federal tax laws designed to stimulate and regulate particular businesses and business practices have been no innovation of recent years as were the various production control levies. Not long after the Federal Government was established, preferential taxes were levied to stimulate particular industries and at the same time to raise revenue. As a result of depressed and fluctuating agricultural prices, a movement was inaugurated in the 1880's to curb speculation in agricultural commodities. Although generally expressing no preference as to method, the agricultural interests finally settled on control through taxation. In 1914, 1916, and 1921, tax laws were enacted which were designed to force speculators in cotton and grain to accept certain standards of conduct. Tax regulations prohibiting the use of tobacco coupons and compensating levies offsetting other taxes have been used to preserve competition. A measure of price control has been secured through the ticket broker tax first levied in 1918 and through the coal taxes of 1935 and 1937. While these taxes have not imposed rigid price controls, they have pointed the way for extensive price regulation when the Federal Government is reluctant to use other controls. The Government has expressed an interest in dividend policies through high levies on undistributed profits which have been designed for the reason among others to force the distribution of such profits. Governmental activity in the particular fields mentioned indicates a possibility of exercising broad control over business through regulation taxation. Such control may well be of a type which would be difficult to secure through more direct methods (ticket broker and coal taxes).

A field for "other than revenue" uses of the taxing power which has barely been touched is that concerning the redistribution of wealth. While one must readily admit that all taxation redistributes wealth, it should be recognized that such redistribution as a general rule is purely incidental to the collection of necessary revenues. Of course such incidental redistribution cannot and has not been ignored by legislators, for consideration of the problem of justice itself implies a recognition of the importance of incidental redistribution. In recent years this normally incidental function of taxation has in a few instances overshadowed the revenue objectives of particular taxes. The 1934 silver transfer tax and the 1936 unjust enrichment or windfall tax were designed to redistribute profits resulting from a change in the Government's monetary policy and from the Supreme Court decision invalidating the processing taxes. In 1913, 1924, and 1935, there were clearly discernible movements in Congress to use the estate and income taxes to effect a redistribution of wealth and income by levying high rates on those individuals who received high incomes or on property transferred at death. The potentialities of such taxation were not unrecognized by many Congressmen, some of whom expressed a desire to establish socialism by this means. Of course taxation to redistribute wealth would also have to secure a great deal of revenue, for only by securing revenue could redistribution take place.

Under our form of government the student of taxation must give due consideration to problems of constitutional law, for no matter how well a particular tax fulfills the canons of taxation, if it is not constitutional, it is unenforceable after the courts have ruled on the question.

The Supreme Court has consistently taken the view that the taxing power contemplates first and foremost the obtaining of revenue for the support of the government. However, the Court has also consistently held to the belief that taxes, by their very nature, must have regulatory or other than revenue effects, which, incidentally, may have been motivating factors in the enactment of the tax. Such motives are perfectly proper if subsidiary to the major purposes of the levy, which is the acqui-

sition of revenue. In spite of the fact that the rates and classifications of particular taxes are inextricably related to revenue or non-revenue purposes, the Court has refused to invalidate a levy simply because the rates were high or the classifications objectionable to the litigant. If the tax were oppressive, the remedy was not with the court but at the ballot box.

The Court has generally refused to look into the motives of Congress in the enactment of particular taxes. When a levy on its face was a revenue measure—only the Court can recognize what is on the face—the Court has refused to go behind the law to inquire into the motives of Congress. That this may have been a convenient subterfuge or that the Court may have changed its views, is indicated by the Court decision in the Railroad Retirement Case in which it construed as one, two acts thought by Congressmen to be legally separate and distinct. But in general, if a tax on its face is for revenue and contains only incidental restrictions which have a relation to the collection of the tax, the levy will be upheld by the Court. If, however, the so-called incidental regulations have no relation to collection, or if they are not incidental at all but are primary, the court will generally invalidate the levy. The Court has also upheld various taxes, even though they were penalties, when the tax has been levied for the purpose of aiding the exercise of another governmental power.

It should be understood that while this summary of the Court's position on regulatory taxation would seem to indicate an absence of opportunity to legislate—many writers believe that the Court does in fact legislate—, such an indication is not real; for who is to say when a tax is, on its face, for revenue purposes, or when incidental purposes are dominant, or when the tax is a mere aid to another power? The Court has the liberty to look at the *Congressional Record*, as it has done, or to ignore it, whichever, at the moment, will lend logical support to its decisions. Like many Congressmen, the Court seems to have an ear to the ground. If the rumblings are not too audible, it has seemingly been inclined to find legal support for taxes levied for what it considers acceptable other than revenue pur-

poses (oleomargarine), and it has found grounds for invalidating taxes levied for non-acceptable purposes (Railroad Retirement Act).

Some writers have believed that several of the taxes invalidated by the Court have very properly been invalidated, for Congress has been so careless as to include incidental provisions obviously regulatory. Had Congress enacted the tax, they maintain, which on its face was only for revenue, it would have been upheld. The Alton decision of 1936 in which two separate laws were construed as one lends little credence to this belief.

On the basis of this study the writer has come to the conclusion that Congress has not hesitated to regulate by taxation when such regulation has not been plainly in opposition to decisions of the courts. Sometimes taxes which appear to be in direct opposition to court rulings have been enacted; however, in almost all, if not all of these cases, Congress has merely sought to give effect to its own interpretation of the Constitution. When a regulatory tax has come before Congress, the major point of discussion has been the problem of policy involved and only incidentally has the so-called abuse of the taxing power been discussed. In a few cases, support has been secured from some Congressmen who objected to the "abuse" of the taxing power simply because of the political inexpediency of expressing objection to taxes having laudable non-fiscal objectives. Those who object most vociferously to taxation for "other than revenue" purposes are almost invariably those who are opposed to the non-fiscal objective itself. Among the more conservative legislators there has been a clearly recognized tendency to associate, perhaps unconsciously, the commonly accepted historical function of taxation with the legitimate function. And upon this arbitrary association rests an implicit argument for the status quo.

Notwithstanding the great intermixture of motives behind the various tax laws, it has been possible to separate roughly those motives which have played a dominant part in the enactment of the levy. Once a tax has been used for non-fiscal purposes, a precedent will have been established, the force of which even the opponents will recognize.

The validity of the statement that Congress is sometimes, in effect, simply a ratifying body has been amply demonstrated. Time and again measures which had been worked out by the executive body were presented and enacted by Congress substantially without change. Particularly has this been true under the strong leadership of President Roosevelt. Furthermore the tremendous importance of the Congressional committees was readily apparent. Here non-revenue objectives were frankly discussed, and if the Committee believed the line of attack to be politically expedient, a favorable recommendation would be given and the measure would generally be enacted into law.

While since 1789 Congress has used the taxing power to secure non-fiscal objectives, only with the Roosevelt Administration has it made extensive use of this method of regulation. This recent development has unquestionably been closely related to the rapid extension of governmental functions arising out of the redefinition of political economic relations growing out of the Great Depression. Through the taxing power the Government has been enabled to extend its jurisdiction without waiting for slow, evolutionary, constitutional development. In short, the taxing power has offered a certain flexibility to a somewhat rigid system.

Perhaps it is superfluous, not to say trite, to remark that this study has reemphasized the belief that people pursue their economic interests. The agricultural groups sought to eliminate their oleomargarine competitors, while many years later the agricultural and the oleomargarine interests combined to curb the producers of colored cooking compound. In the future trading acts and in the production control acts, agricultural groups again sought to improve their economic position through regulatory taxes. The internal excises on imported products were levied as a result of strong pressure from those who expected to benefit. In practice many of the taxes for non-revenue objectives have owed their existence to the aggressive support of those groups who expected to gain economically from the tax.

In general, it may be stated that since we operate under a constitutional system, the taxing power should be used whenever

it offers the best means of attaining a given end, subject to the qualification that it should never be used to circumvent the Constitution. The member of Congress, in voting on tax laws, should be guided by what he himself considers to be constitutional limitations. Environmental considerations will perhaps determine whether an individual will construe the Constitution broadly or narrowly, whether the general welfare clause grants power sufficient to override other sections of the Constitution, and whether emergencies extend governmental power.

It should be recognized that frequently the taxing power offers the best means to accomplish particular ends. Through this device limited coercion may be exercised where absolute prohibition is undersirable. A more rapid and more economical means of effectuating particular policies may be secured by utilizing the administrative organization already set up for the collection of taxes, and furthermore, incidental information may very readily be secured. Moreover, the taxing power offers the most practical way for redistributng wealth and income and for aiding particular industries. In general, Congress should not be curbed in its use of the taxing power for non-revenue purposes by preconceived notions as to the legitimate scope of this authority. It should, however, bear in mind that such taxes, as well as taxes for revenue, often have important effects, which are not immediately recognized, on capital accumulation, business conditions, and particular businesses.

VITA

Julian Donald Morgan was born in Fond du Lac, Wisconsin, May 13, 1911. He was graduated from high school in 1929 after having acquired both primary and secondary education in Columbus, Kansas. In September, 1930, he entered the University of Illinois, from which he received a Bachelor of Arts degree with high honors in 1934. The Master of Arts degree in Political Science was conferred in 1935. The academic year 1935-36 was spent at Louisiana State University where he held a fellowship in Political Science and where he collaborated in a published study on Louisiana government. The following year was spent at the University of Illinois pursuing work in Political Science and preparing with Professor C. S. Hyneman an article on cumulative voting in Illinois. Since 1937 he has been an assistant in the Department of Economics at the University of Illinois.

